DEPARTMENT OF STATE REVENUE

04-20150611.LOF
04-20150612.LOF
04-20150613.LOF

Letters of Finding: 04-20150611; 04-20150612; 04-20150613
Gross Retail Tax
For the Years 2010, 2011 and 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

The Department was not barred by the three-year statute of limitations in assessing Restaurants additional sales tax because the Restaurants filed fraudulent tax returns; Restaurants failed to provide documentary evidence sufficient to justify reconsidering the tax assessments originally based on the Department's review of the best information available; Restaurants failed to establish that the 100 percent fraud penalty was unwarranted.

ISSUES

I. Tax Administration - Fraud Penalty.

Authority: IC § 6-8.1-10-4(a); 45 IAC 15-5-7(f)(3); 45 IAC 15-5-7(f)(3)(A); 45 IAC 15-5-7(f)(3)(B); 45 IAC 15-5-7(f)(3)(C), (D), (E).

Taxpayers argue that the Department was not justified in imposing a 100 percent fraud penalty.

II. Gross Retail Tax - Statute of Limitations.

Authority: IC § 6-8.1-5-4; IC § 6-8.1-5-4(b)(1); IC § 6-8.1-5-1(c); IC § 6-8.1-5-2(a); IC § 6-8.1-5-2(f); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Leehaug v. State Bd. of Tax Comm'rs, 583 N.E.2d 211 (Ind. Tax Ct. 1991).

Taxpayers argue that the Department's assessments of additional sales tax were invalid because the assessments were issued outside the three-year statute of limitations.

III. Gross Retail Tax - Best Information Available Assessment.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-9-3; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); IC § 6-8.1-5-4(b); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 15-5-1.

Taxpayers maintain that the assessment of sales tax is excessive because the Department overstated the amount of their restaurant sales.

STATEMENT OF FACTS

Taxpayers are three Indiana restaurants. The Indiana Department of Revenue ("Department") initiated an investigation of Taxpayers' business practices. The Department's "Special Investigation Division" executed search warrants of Taxpayers' business locations November 18, 2013. The Department simultaneously subpoenaed Taxpayers' bank account information.

Members of that Division and members of the Department's Enforcement Division reviewed the records obtained during the search along with Taxpayers' bank account information. As a result of the Department's review of that

information, the Department determined that Taxpayers had under-reported the amount of Taxpayers' restaurant sales.

The Special Investigations Unit issued a "Case Report" December 15, 2014, finding that "[t]here [was] sufficient convincing evidence to support the under-reporting of sales by the three [] restaurants . . . ." That report led to the filing of criminal charges against the restaurants' owners June 3, 2015. A "Plea Agreement" was filed with the court July 1, 2015 with sentencing of the owners taking place August 12, 2015.

The Department assessed additional sales tax August 18, 2015. The Department issued assessments for 2010, 2011, and 2012. Taxpayers disagreed with the assessments and submitted protests to that effect. An administrative hearing was conducted during which Taxpayers' representatives explained the basis for the protest. This Letter of Findings results.

I. Tax Administration - Fraud Penalty.

DISCUSSION

The issue is whether the Department was legally and factually justified in assessing Taxpayers a 100 percent fraud penalty.

The Department assessed the penalty because of the apparent disparity between the amount of taxes Taxpayers received from their customers and the amount of taxes which were forwarded to the Department. Taxpayers complain of this assessment stating that the penalty was unjustified.

IC § 6-8.1-10-4(a) states that, "If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, the person is subject to a penalty. (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100[percent]) multiplied by: (1) the full amount of the tax, if the person failed to file a return; or (2) the amount of the tax that is not paid, if the person failed to pay the full amount of tax."

The pertinent Indiana regulation, 45 IAC 15-5-7(f)(3), states:

> A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements to fraud.
>
> (A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the [D]epartment's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.
>
> (B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.
>
> (C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the [D]epartment to believe a given set of facts which are not true, the person has deceived the [D]epartment.
>
> (D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the [D]epartment to rely on these acts to the detriment or injury of the [D]epartment, the reliance requirement of fraud will be met.
>
> (E) Injury: The fraud instituted upon the [D]epartment must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the [D]epartment not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the Department is required to prove from the record each of the above elements set out in 45 IAC 15-5-7(f)(3). Based upon the substantial disparity between the amount of the Taxpayers' actual taxable sales and the amount of taxable sales reported to the Department along with evidence of sales to Indiana customers for which no sales tax was charged, the Department was entitled to conclude that Taxpayers

committed a "misrepresentation of material fact," pursuant to 45 IAC 15-5-7(f)(3)(A).

Bearing in mind that Taxpayers' owner was charged with and pled guilty to criminal theft of sales tax and failure to collect tax, Taxpayers had actual knowledge of the repeated misrepresentations or, in the alternative, Taxpayers exhibited a reckless disregard for the truth. In that plea agreement, Taxpayers' owner admitted the truth of all the facts alleged in charges against him and agreed to pay restitution to the state in an amount reflecting the Department's calculation of the underreported taxes for each of the restaurants. As a result, the Department reasonably concluded that Taxpayers exhibited the "scienter" element required under 45 IAC 15-5-7(f)(3)(B).

The Department accepted and relied upon the sales tax returns and Taxpayers' representations as to its taxable sales for a period of up to three years. In deciding to impose the 100 percent fraud penalty, the Department was justified in concluding that Taxpayers acted with intent to deceive, that the Department had mistakenly relied upon Taxpayers' representations, and that the Department was "injured" because it failed to collect the amount of sales tax to which it - and by implication the state of Indiana - was entitled. Therefore, the three elements of fraud set out in 45 IAC 15-5-7(f)(3)(C), (D), and (E) are met.

FINDING

Taxpayers' protest is denied.

II. Gross Retail Tax - Statute of Limitations.

DISCUSSION

The issue is whether the assessment of additional tax is barred on the ground that the assessments - at least in part - were assessed beyond the three-year statute of limitations.

Taxpayers argue that the sales tax assessments are barred by the three-year statute of limitations because Taxpayers did not receive notice that they were suspected of having filed fraudulent tax returns. Taxpayers explain that since the proposed assessments were issued August 18, 2015, "the statute of limitations applies and the proposed assessments for tax years 2010 and 2011 are invalid."

As a threshold issue, it is the Taxpayers' responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the Department's decision to issue the assessments, are entitled to deference.

Taxpayers argue that the assessments are barred by the three-year statute of limitations set out at IC § 6-8.1-5-2(a). The statute provides in part as follows:

> Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed, or either of the following: (1) The due date of the return.

However, IC § 6-8.1-5-2(f) provides:

> If a person files a fraudulent, unsigned, or substantially blank return, or if a person does not file a return, there is no time limit within which the department must issue its proposed assessment.

Nonetheless, Taxpayers cite to IC § 6-8.1-5-4(b)(1) for the proposition that the assessments are barred because Taxpayers did not receive notice from the Department that any of their tax returns were "fraudulent." IC § 6-8.1-5-4 provides as follows:

> (a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.
>
> (b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person has filed:
> (1) for an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or
> (2) in all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction.
>
> In addition, if the limitation on assessments provided in section 2 of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.
> (c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times. (Emphasis added).

According to Taxpayers, because they did not receive notice that their sales tax returns were "fraudulent," the assessments are time-barred. As explained by Taxpayers' representatives:

> [IC § 6-8.1-5-4] requires the IDOR to send the [T]axpayers written notice within the 3-year statute of limitations, that the filed returns were "suspected" fraudulent. Without the issuance of such notice, the [T]axpayer[s] [were] not put on notice that the IDOR intends to issue an assessment outside of the statute of limitations and that records must be maintained accordingly. The IDOR's inaction particularly when it presumably had facts available to it [i]n November 2013 to issue proposed assessments, did not toll the otherwise applicable statute of limitations.

The Department's investigation of Taxpayers' business practices found that "source documents were not kept by the restaurants" as required by IC § 6-8.1-5-4. The Department's audit report also notes that the Taxpayers' owner was charged with and pled guilty to theft of sales tax collected from Taxpayers' customers.

The Department does not agree with Taxpayers' reliance on IC § 6-8.1-5-4 because the statute addresses the length of time that Taxpayers are required to retain their business records. Under that provision, taxpayers may be required to retain records for an indefinite period if the affected taxpayer receives notice from the Department that it suspected that the taxpayers filed fraudulent returns. IC § 6-8.1-5-4 does not impose a limitation under which assessment of additional tax may be imposed.

The issue of whether the assessments are barred arises under IC § 6-8.1-5-2(a) because the assessments were made outside the three-year limitations. The assessments are not barred because Taxpayers' filed fraudulent returns as plainly evidenced by their owner's decision to plead guilty of stealing sales tax collected from Taxpayers' customers or failing to collect sales tax from those customers. In addition, the reports issued by the Department's Special Investigation Division provide stark and detailed evidence that Taxpayers failed in their obligation to collect, properly account for, report, and remit Indiana sales tax.

The Department concludes that IC § 6-8.1-5-2(f) says what it means and means what it says. As the Tax Court has explained, statutory construction starts with the "plain and ordinary meaning of the language used." Leehaug v. State Bd. of Tax Comm'rs, 583 N.E.2d 211, 212 (Ind. Tax Ct. 1991). IC § 6-8.1-5-2(f) provides in "plain and ordinary" language if a person files a "fraudulent" return, "there is no time limit within which the department must issue its proposed assessment."

FINDING

Taxpayers' protest is denied.

III. Gross Retail Tax - Best Information Available Assessment.

DISCUSSION

Taxpayers argue that the assessments of additional sales tax are over-stated because Taxpayers can establish that its sales are less than determined by the Department.

As a threshold issue, it is the Taxpayers' responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the [D]epartment's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A retail merchant - such as Taxpayers - is required to "collect the tax as agent for the state." IC § 6-2.5-2-1(b). The retail merchant "holds those taxes in trust for the state and is personally liable for the payment of those taxes . . . ." IC § 6-2.5-9-3.

The audit found that Taxpayers failed to maintain accurate and complete sales records. The audit also found that Taxpayers failed to file all the requisite tax returns.

In the absence of returns and source documentation, the audit made a determination of the tax due based on the "best information available."

As a business conducting retail transactions and collecting sales tax, Taxpayers are required to maintain accurate financial records. "Every person subject to a listed tax must keep books and records so that the Department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a). "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b). See also 45 IAC 15-5-1.

The Department's investigation found that Taxpayers failed to maintain "source documents" and that it was Taxpayers' practice to destroy "guest check tickets" on a regular basis. In addition the audit questioned the accuracy of Taxpayers' daily summary register tapes ("z-tape") because the cash register daily tapes were not retained. The audit report also indicates that it was the practice of Taxpayers' employees to "register a lesser amount than the actual sales price," used the "no sale" register button to ring up particular transactions, and routinely "left the cash register drawer open between customers." Further, the audit found that a review of Taxpayers' bank accounts established "that there were no cash deposits for many months, and often there were no cash deposits for years."

In reviewing Taxpayers' general ledgers, the Department found that Taxpayers' "[r]evenues were increased and cash on hand was increased in order to balance [] accounting entries." According to the Department's investigative report, Taxpayers' practice of adjusting the general ledger entries "indicates the business was not reporting all their sales" and that Taxpayers' records were incomplete and unreliable.

Rather than relying on the available records which it determined were incomplete and unreliable, the audit resorted to calculating the amount of sales tax correctly based on Taxpayers' "cost of goods sold." As explained in the audit report:

> After a review of the records, it was determined that the restaurants were under-reporting sales to the Indiana Department of Revenue. Records reviewed were inadequate to support a determination of the [T]axpayer's Indiana sales tax liability. Because the Department could not rely on the [T]axpayer's records and because of the extremely low cash deposits, an indirect method was utilized to determine the amount of under-reporting by each restaurant.

Nonetheless, Taxpayers now claim that the assessments are "inaccurate" and criticizes the Department's use of a "3.5 multiplier of its costs of goods sold . . . ." To that end, Taxpayers have supplied copies of their federal income tax returns along with an alternative calculation of the underreported taxes. Taxpayer explains:

> All three (3) [Taxpayer] restaurants submitted ST-103s for every applicable month for every year at issue via a professional accounting firm []. In other words, this is not a situation where a taxpayer failed to submit

returns or failed to submit payment of the tax due, per the return. Instead, for each restaurant, a tax professional was utilized to assist in the filing of sales tax returns and submission of payment.

However, the alternative calculation is based on the same flawed data that the Department rejected in its initial investigation. The alternative calculation is based on a review of selected monthly packets of information sent to the Taxpayer's accountant on a monthly basis. The data in these monthly packets is based wholly on "z-tape" daily taxable sales. The Department's audit confirmed that the "z-tape" sales data was incorrect and substantially lower than actual sales made by each of the Taxpayers. Taxpayers alternative calculations based on cost-of-goods to sales ratio are not valid.

In order for the Department to consider reviewing the assessments, Taxpayers are required by the law to establish that the assessments are "wrong." IC § 6-8.1-5-1(c). Taxpayers have provided no source data and nothing of substance which would warrant such a review of the Department's assessments. Although Taxpayers believe that the assessments are either excessive or entirely unwarranted, they have provided no source documentary evidence which would support such a conclusion as required by IC § 6-8.1-5-4(a).

FINDING

Taxpayers' protest is denied.

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